IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 365

EDWARD R. DOWNING, suing on his own behalf and on behalf of all other stockholders of THE UNITED CORPORATION (of Delaware), etc.,

Petitioner,

against

GEORGE H. HOWARD and others.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR DEFENDANTS EDWARD HOPKINSON, JR. AND OTHERS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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Opinions Below

The opinion of the Third Circuit Court of Appeals (insert following R. 152a) is reported in 162 F. (2d) 654, and the opinion of the District Court (R. 126a) in 68 F. Supp. 6.

Jurisdiction

Jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended (28 U. S. C. 347). The judgment of the Circuit Court of Appeals was entered June 24 1947. Plaintiff's petition for certiorari was filed September 23 1947.

Statement of the Case

This is a derivative action by a minority stockholder of The United Corporation (a Delaware corporation) against it, numerous officers and directors, and banking firms named as third parties, for waste claimed to have been committed by the defendant directors and officers at the instance of the third parties in the management of the corporation in and after 1935. In the absence of diversity of citizenship (plaintiff and three of the defendants being all citizens of Massachusetts, R. 12a-13a), plaintiff has sought to obtain Federal jurisdiction of the subject-matter and extra-territorial jurisdiction of the individual defendants by injecting into the complaint a charge of violation of the Public Utility Holding Company Act of 1935. Section 25 of this Act (quoted at pp. 4-5 below) confers jurisdiction upon the United States courts "of all suits in equity . . . brought to enforce any liability or duty created by" the Act, and allows process in such suits to be served in any district wherein the defendant is an inhabitant or transacts business or wherever defendant may be found.

The complaint was filed in the United States District Court for Delaware August 10 1944. A year or more later, in reliance upon Section 25, plaintiff caused process to be served upon 23 defendants (or their estates) in Massachusetts, Connecticut, New York and Pennsylvania (R. 1a-7a), three defendants only out of the list of 26 having been served in the forum (Delaware). The amount claimed from the defendants jointly and severally exceeds $100,000,000 (R. 63a).

The amended complaint proceeds under a standard head of equity jurisdiction in accusing the defendant directors and officers as fiduciaries of deliberate mismanagement of

the company for the benefit of the third-party banking firms. But in order to try to bring the claim under the Public Utility Holding Company Act as being one first created by the Act, plaintiff alleges that the defendant directors and officers wrongfully caused the company to remain unregistered under the Act from 1935 to March 28 1938.[1] The theory of the complaint is that from August 26 1935 (the effective date of the Act) the defendant directors and officers "in furtherance of a fraududent conspiracy to waste and dissipate the assets of United" (R. 56a) caused the company to remain unregistered, to retain the stocks of holding companies, and to vote in favor of consolidation of subsidiary holding companies; and that after registration in 1935 they caused it for three years to fail to submit to the Securities and Exchange Commission a proper plan of reorganization and divestment.[2] Thus an attempt is made to spell out a statutory violation, but as a matter of necessity the complaint is replete also with the standard charges of waste, negligence, and fraudulent conspiracy (R. 32a-35a, 37a, 43a, 46a and 56a).

Petitioner concedes that the process of the District Court of Delaware could not run beyond the limits of that district so as to reach the undersigned defendants unless Section 25 of the Act here applies—unless, in other words, the amended complaint upon proper analysis shows the action to be one to enforce a "liability or duty created by" the Act (br. pp. 2, 21).

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[1]Registration on March 28 1938 coincided, as the Circuit Court points out (opinion at p. 4 following R. 152a, 162 F. [2d] at 656), with the decision of this Court upholding the constitutionality of the registration provisions of the statute. *Electric Bond & Share Co.* v. *S. E. C.*, 303 US 419.

[2]The three alleged causes of action are summarized at greater length in the petition, pp. 3-10.

The undersigned nine defendants, together with 16 other defendants represented by other counsel, seasonably moved to dismiss the complaint for lack of jurisdiction (Rule 12[b]). The motions were granted and judgments of dismissal entered (R. 140a, 142a, insert following R. 152a). Judge Leahy in the District Court and a unanimous Circuit Court of Appeals for the Third Circuit reached the conclusion that the action is no more than the standard derivative suit in equity by a minority stockholder to call fiduciaries to account; that it does not seek to enforce a duty or liability first *created* in 1935 by the statute; and that therefore Federal jurisdiction of the subject-matter and of the persons does not exist in the absence of diversity.

Statute Involved

Public Utility Holding Company Act of 1935 § 25 (15 U. S. C. § 79y) provides:

> "Jurisdiction of offenses and suits
>
> The District Courts of the United States, the Supreme Court of the District of Columbia, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have jurisdiction of violations of this chapter or the rules, regulations, or orders thereunder, and, concurrently with State and Territorial courts, of all suits in equity and actions at law *brought to enforce any liability or duty created by*, or to enjoin any violation of, this chapter or the rules, regulations, or orders thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by, or to enjoin any violation of, this chapter or

rules, regulations, or orders thereunder, may be brought in any such district or in the district wherein the defendant is an inhabitant or transacts business, and process in such cases may be served in any district of which the defendant is an inhabitant or transacts business or wherever the defendant may be found. . . ." (italics supplied)

Question Presented

Petitioner has sought (Pet. pp. 10-11) to state three questions as being presented by his application. Each question is tied in to one of his three alleged causes of action, and he contends that the writ should issue if his position is right as to any one cause of action (p. 11). The question here presented therefore boils down to one only, namely:

Where fiduciaries are charged in a derivative suit with fraudulent conspiracy, waste and negligence, does the added allegation of a breach of the Public Utility Holding Company Act of 1935 transform the derivative suit into one "to enforce any liability or duty created by" that statute, so as to confer jurisdiction upon the United States courts in the absence of diversity of citizenship?

Argument

1. Upon proper analysis the amended complaint here is no more than the standard derivative action in equity.

Petitioner seeks to give the impression that upon this case turns the question whether from now on faithless directors of corporations subject to the Act shall be civilly liable for their dereliction of duty (cf. br. p. 20). As peti-

tioner would have it, the Act "enlarged the fiduciary obligation of directors" (br. pp. 20, 41), by requiring that they act "for the best interests of securityholders" instead of for conflicting interests. Any such contention is so lacking in all foundation as to demonstrate the fallacy of the petition. For a hundred years or more the requirement that company directors act for the best interest of their stockholders, and sanctions against their acting for conflicting interests, have existed in the form of the standard derivative action, as illustrated by the decisions of this Court (*Pepper* v. *Litton,* 308 US 295; *Southern Pacific Co.* v. *Bogert,* 250 US 483), as well as innumerable decisions in the State and lower Federal courts. *Gallin* v. *National City Bank,* 155 Misc. 880; *Loft Inc.* v. *Guth* (Del. Ch. 1938), 2 Atl. (2d) 225, affd. 5 Atl. (2d) 503; *Kavanaugh* v. *Kavanaugh Knitting Co.,* 226 NY 185; *Irving Trust Company* v. *Deutsch,* 73 F. (2d) 121, cert. den. 294 US 708.

If the fiduciary obligation of the defendants sought to be enforced by this action is one which existed before 1935 and the remedy here invoked was likewise previously available, then it is obvious that the present action is not one to enforce a duty or liability first *created* by the Act.[3] Demonstration, if more were needed, is furnished by the pleading of a claim substantially identical with that of this plaintiff, by another minority stockholder in the New York courts, sustained by Mr. Justice Shientag as stating a cause of action at common law, independent of any statute.

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[3] Judge Goodrich well points out this essential weakness of plaintiff in footnote 3, 162 F. (2d) at 655.

Singer v. *Carlisle*, 26 NYS (2d) 172 (1940), affd. on other grounds 261 AD 897.[4]

This pre-1935 common law liability and fiduciary obligation, which indeed the plaintiff here invokes in his pleading (R. 32a-35a, 37a, 43a, 46a, 56a), is of course not materially altered, not changed in quality, by the pleader's adding to the list of wrongs recited a violation of the Public Utility Holding Company Act. Such violation, if it existed, was but an evidentiary detail of the defendants' alleged misconduct. The fiduciary duty and liability of the defendants here sought to be enforced existed before the enact-

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[4]This case was brought against some of the present defendants. The New York Court said, describing the pleading (pp. 179-80):

> "The theory of the third cause of action is the elimination by the fiduciaries of their cestui as a competitor. In other words, plaintiffs charge that the defendant bankers and directors of the United Corporation and New York United Corporation, acting in concert with the defendant bankers, made no effort to obtain the underwriting business in connection with the issue of securities and, further, that the defendant bankers, by virtue of their domination and control over the United Corporation and New York United Corporation, fraudulently caused the latter corporations to use their influence and control over their subsidiaries in order to induce such corporations to award the underwriting business to the defendant bankers. Having thus eliminated the United Corporation and the New York United as their competitors for the underwriting business of the subsidiaries, the defendants, it is alleged, proceeded to utilize their domination, control and influence in order to obtain this business for themselves.
>
> This conduct on the part of the fiduciaries if established on a trial would amount to a violation of their legal obligation to the corporations they were elected to serve and for such violation they would have to respond in damages to the cestuis, namely, the United Corporation and New York United Corporation."

ment of the statute. It is transparent therefore that the statute did not "create" it. But if the statute did not create the duty or liability here sought to be enforced, petitioner agrees that there is no Federal jurisdiction.

2. There is no diversity among the Circuit Courts upon the question presented here.

The only conflict among the Circuits which petitioner claims in respect of the decision below has to do with the decision of the Second Circuit Court of Appeals in *Goldstein* v. *Groesbeck,* 142 F. (2d) 422, cert. den. 323 US 737, although petitioner admits that the opinion of the Third Circuit "did not express any disagreement with the decision in that case" (Pet. p. 13). The claim of a conflict, in other words, is inferential only. It is said that "the bases of the decision are in conflict". However, an analysis of the *Goldstein* case will show that this is not so. The Third Circuit refers to the *Goldstein* case in connection with its statement that violation of the registration provisions of the Act might in certain situations involve liability, which would thus have been "created" by the Act (p. 7 following R. 152a, 162 F. [2d] at 658). However, the further statement of the Third Circuit that the violation alleged in this instance had nothing to do with the duty or liability here invoked rests, we submit, upon unassailable reasoning.

Otherwise with the *Goldstein* case. The wrong there asserted was not a wrong before enactment of the Act and with first made illegal by that event. Judge Clark there said (142 F. [2d] at 425) that the suit

> "is surely to enforce a duty created by the Act, since but for the Act the payment under the service and construction contracts would be innocuous enough. . . ."

Plainly such a holding based upon the specific terms of § 26(b) of the statute declaring void contracts made in violation of the statute, can have no bearing upon the situation here presented of alleged violation of pre-existing equitable duty combined with violation of the Act. The distinction was pointed out by the Second Circuit Court of Appeals itself, in a derivative suit based on the Sherman Act. *Meyer* v. *Kansas City Southern R. Co.*, 84 F. (2d) 411 at 414. This Court denied certiorari, 299 US 607.

3. The canons of construction uniformly applied on questions of Federal jurisdiction forbid judicial extension of that jurisdiction to cases for which Congress has not expressly provided.

If petitioner were right in his claim that Congress by the Public Utility Holding Company Act had "enlarged" the fiduciary obligations of directors and created a new forum to punish their violation, it would have been easy for Congress to say so. When in the course of the enactment Congress desired to provide private civil remedies for enforcing the Act, it so specified, as in Section 17(b) authorizing suits to recover profits from officers and directors of registered holding companies in respect of the purchase and sale of the securities of such companies, or in Section 16, which really "creates" liability for the making of false or misleading statements in applications and other papers filed pursuant to the Act.

But with respect to the civil remedy which petitioner asserts that Congress intended to confer for the purpose of derivative suits against directors in respect of failure of their companies to be registered under the Act, Congress has been conspicuously silent. This fact is most significant under the standard canon of construction of the Federal

jurisdiction which this Court applies. Such construction is restrictive. Jurisdiction will not be inferred where Congress has not expressly conferred it. The rule is so well established that it is sufficient merely to refer to *Indianapolis* v. *Chase National Bank,* 314 US 63, 76-7; *Thomson* v. *Gaskill,* 315 US 442, 446; *Healy* v. *Ratta,* 292 US 263, 270; *Kresberg* v. *International Paper Company,* 149 F. (2d) 911, cert. den. 326 US 764 (1945).

4. The decision below does not determine for other cases the existence of the right of a private party to enforce Sections 4 or 11(e) of the Act where the circumstances render such enforcement appropriate.

Petitioner urges that the question presented here is whether a private party has the right to bring an action for violation of the registration clauses of the Act, arguing at length that the statute was passed for the benefit of investors and that the problem of their protection as a class is presented by this case (br. pp. 22-3 etc.).

It is clear, however, that the Court of Appeals did not pass on this question but on the contrary expressly left it open. The Court said (pp. 7, 9 following R. 152a, 162 F. [2d] at 658, 659):

> "We are unwilling to take the position urged by the defendants that the violation of the registration provisions of the statute will never bring about individual liability. Violation has been held liability creating in one situation. [Reference to *Goldstein* v. *Groesbeck,* 142 F. (2d) 422; cert. den. 323 U. S. 737.] It may or may not be in others. This case is decided on a narrower ground.
>
> . . . . .
>
> Our conclusion is, with regard to plaintiff's first and second claimed causes of action, that we need

not commit ourselves on the question whether violation of registration requirements may in some circumstances be made the foundation of assertion of private rights. We shall answer that question when a case compels us to do so. It is sufficient to say that such circumstances are not here presented by the plaintiff. We think that here, even if the violation of the statute could be made the basis of recovery, this plaintiff has not, even when we take all his allegations as true, brought himself into the area of recovery."

It is thus obvious that the decision here sought to be reviewed passed on a particular state of facts and did not involve any important Federal question or question of general law.

CONCLUSION

The petition presents no conflict among the circuits and no important question of Federal or of general law, but merely an attempt to obtain Federal jurisdiction in a standard minority stockholder's action without diversity of citizenship. The writ should therefore be denied.

Respectfully submitted,

RALPH M. CARSON
Attorney for Defendants Edward Hopkinson, Jr., George Whitney, Thomas W. Lamont, Russell C. Leffingwell, Arthur M. Anderson, Charles D. Dickey, J. P. Morgan & Co. Inc., Eva R. Stotesbury and Charles D. Dickey as Executors under the Last Will and Testament of Edward T. Stotesbury, deceased, and Charles D. Dickey as one of the Executors under the Last Will and Testament of Horatio G. Lloyd, deceased, appearing specially

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